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Unsecured Creditors of TWN Investment Group, LLC

**IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION**

In the Matter of

Case No. 13-50821 SLJ

TWN INVESTMENT GROUP, LLC,

Chapter 11

Honorable Stephen L. Johnson

Debtor.

**OPPOSITION OF THE OFFICIAL
COMMITTEE OF UNSECURED
CREDITORS TO EAST WEST BANK'S
MOTION FOR RELIEF FROM STAY
UNDER 11 U.S.C. § 362(d)(2)**

Date: October 15, 2013

Time: 10:00 a.m.

Place: Courtroom 3099
280 South First Street, Third Floor
San Jose, CA 95113

1 TO THE HONORABLE STEPHEN L. JOHNSON, UNITED STATES BANKRUPTCY
2 JUDGE:

The Official Committee of Unsecured Creditors of TWN Investment Group, LLC (the “Committee”), a party in interest in the case of TWN Investment Group, LLC (the “Debtor”), submits this Opposition to the “*Motion for Relief from Stay under 11 U.S.C. § 362(d)(2)*” [docket no. 116] (the “Motion”) filed by East West Bank (the “Bank”). In support of its Opposition, the Committee respectfully represents as follows:

9 | I. FACTUAL BACKGROUND

On May 15, 2013, the Court entered an order authorizing an examination of the Bank under Bankruptcy Rule 2004.¹ In response, the Bank produced over ten thousand pages of documents to the Committee. The documents produced detail some of the history of the Debtor's loans with the Bank.

As obliquely referenced by the Bank in the Motion, the Debtor is in the business of developing the real property located at 915 Story Road, San Jose, California (the “Real Property”), primarily to be sold as commercial condominiums. In early 2005, the Debtor acquired the Real Property. The Debtor financed its acquisition of the Real Property, in part, through a secured loan (the “Land Loan”) that it obtained from United Commercial Bank (“UCB”—the Bank’s predecessor-in-interest. At the time, the Debtor was also taking deposits from potential purchasers of commercial condominiums to be developed at the Real Property though no such condominiums had been built (the “Purchasers”). (See, e.g., Claims Registry, Proof of Claim No. 5, underlying contract dated October 8, 2004.)

23 The Debtor and UCB agreed to modify the Land Loan on several occasions, ultimately
24 agreeing to increase the principal amount of the Land Loan to \$18,860,000 and extend the maturity
25 date to October 5, 2009. Following its acquisition of the Real Property, the Debtor began
26 developing the Real Property and solicited additional financing from UCB. On or about November

¹All code, section, and rule references refer to the Bankruptcy Code (11 U.S.C. §§ 101, *et seq.*) and the Federal Rules of Bankruptcy Procedure (Rules 1001 - 9037), unless otherwise stated or indicated by the context.

1 2008, the Debtor obtained a construction loan from UCB in the original principal sum of
2 \$31,140,000 (the “Construction Loan”) with a maturity date of December 12, 2009. Both loans
3 were secured by separate Deeds of Trust against the Real Property.

4 The Debtor and UCB negotiated the terms of the Construction Loan over a lengthy period
5 of time. As a condition to extending the Construction Loan, UCB demanded that the Debtor either
6 obtain subordination agreements from the Purchasers or an amendment to their purchase agreements
7 whereby the Purchasers would waive any lien rights they may have and acknowledge the seniority
8 of UCB’s liens. Eventually, UCB waived the conditions that the Debtor obtain subordination
9 agreements, satisfied with the Debtor obtaining amendments to the purchase agreements from the
10 Purchasers. (Gomez Decl. ¶¶ 4 - 11, Exhs. 2 - 9; Nguyen Decl. ¶ 5, Exh. 1; Claims Registry, Claim
11 No. 3, subpart 4 (section XI.B.1. of the Construction Loan’s Promissory Note).)

12 The Debtor did not obtain purchase agreement amendments from all the Purchasers. (*See*,
13 *e.g.*, Claims Registry, Proof of Claim Nos. 5, 7 - 20; Nguyen Decl. ¶ 5; Gomez Decl. ¶¶ 11 - 12,
14 Exhs. 9 - 10.)² UCB was clearly concerned that the Debtor’s failure to obtain such amendments
15 would cause its first Deed of Trust for the Land Loan to lose priority to the Purchasers. On several
16 occasions, in its own internal memoranda, UCB admitted:

17 UCB has now received the executed Second Extension Agreements and Second
18 Amendments to the Purchase and Sale Agreement and Escrow Instructions dated
9/1/07 from the Phase I Buyers, but not from the Phase 2 and 3 Buyers. Not
19 obtaining Second Extension Agreements and Second Amendments to the
Purchase and Sale Agreement and Escrow Instructions dated 9/1/07 from the Phase
2 and Phase 3 Buyers may give the Phase 2 and 3 Buyers a priority lien ahead
of UCB’s First Deed of Trust.

21 (Gomez Decl. ¶¶ 11 - 12, Exhs. 8 - 9.) (Emphasis added.)

22 In addition, to these lien priority issues, the Bank’s appraisal estimates the value of the
23 completed units for the Real Property at \$16,200,000 on a bulk sale basis. The appraisal assumed
24 there are 59 units comprising 59,957 square feet.³ (Motion, Exh. 1, internal page 22.) On a per unit
25

26 _____
27 ²There is no indication that the Purchasers’ contracts were ever recorded. (*E.g.*, Claims
Registry, Proof of Claim No. 4, subparts 14 - 20, Trustee’s Sale Guaranty.)

28 ³There may be fewer units available now in light of the prior sale motions approved by
the Court.

1 basis, the bulk value is \$274,576 per unit, assuming each unit is approximately 1,016 square feet.
2 Multiple creditors in this case are willing to waive their claims and purchase the units based on the
3 Bank's bulk value per unit, indicating that the Bank has undervalued its collateral. (Nguyen Decl.
4 ¶¶ 3 - 4.)

5

6 **II. ARGUMENT**

7 **A. SINCE THE PRIORITY OF THE BANK'S LIENS ARE IN BONA FIDE DISPUTE,
8 THE BANK CANNOT PROVE THE ESTATE LACKS EQUITY IN THE
9 PROPERTY**

10 **1. Absence of Priority of the Bank's Liens is a Defense to Relief From Stay.**

11 Multiple courts, including the Ninth Circuit Court of Appeals, hold that on a motion for
12 relief from stay, a court should consider affirmative defenses and counterclaims that directly involve
13 the validity of the movant's security interest and/or the debtor's equity in the property. "When a
14 debtor's affirmative defenses and counterclaims [to the creditor's stay relief motion] directly
15 involve the question of the debtor's equity, they should be heard in the stay proceeding." *In re*
16 *Bialac*, 694 F.2d 625, 627 (9th Cir. 1982); *In re Kaplan Breslaw Ash, LLC*, 264 B.R. 309, 327 n.
17 64 (Bankr. S.D.N.Y. 2001) (same) (cited by the Bank in the Motion); *In re Poughkeepsie Hotel*
18 *Assocs. Joint Venture*, 132 B.R. 287, 291 (Bankr. S.D.N.Y. 1991).

19 In sum, then, when affirmative defenses or counterclaims are asserted and raised
20 which strike at the heart of the amount of the creditor's claim or the validity of his
lien, such defenses or counterclaims directly affect the issue of equity and thus the
21 issues of harm and adequate protection, as well as the reasonable probability of any
plan of reorganization. When such are asserted or raised, the court should give
22 consideration to them in determining whether or not the stay should remain in effect.

23 *United Cos. Fin. Corp. v. Brantley*, 6 B.R. 178, 188 (Bankr. N.D. Fla. 1980).

24 Courts that have confronted the issue have determined that any colorable challenge to the
25 moving party's security interest, whether it be to the extent, validity, or priority of the security
interest, uniformly agree that the challenge constitutes a valid defense in a relief from stay
26 proceeding. See, e.g., *In re Hubbel*, 427 B.R. 789, 794-798 (N.D. Cal. 2010) (affirming
27 maintenance of stay to determine TILA issues that might void security interest) (Breyer, J.); see also
In re Franklin Equip. Co., 416 B.R. 483, 503-507 (Bankr. E.D. Va. 2009) (synthesizing cases

1 treating relief from stay as a summary proceeding and distinguishing them from cases where the
2 respondent challenged the validity of the creditor's lien and therefore the equity in the property).

3 For example, in *Poughkeepsie Hotel*, the court reasoned as follows:

4 The rationale for allowing the affirmative defense of equitable subordination to a
5 motion for relief from the automatic stay is easily illustrated. Where a foreclosure
6 action is pending, a debtor may file a bankruptcy petition or its creditors may
7 commence an involuntary petition against the debtor to stay the foreclosure sale.
8 Upon commencement of the bankruptcy case, the debtor and its unsecured creditors
9 have a "variety of protections under the Bankruptcy Code to capture any equity in
the property, subject to providing adequate protection to the secured creditor." These
protections include [avoidance of post-petition transfers, recovery of preferences, and equitable subordination]. Should, for example, the respondent to a motion for relief from the automatic stay prevail on an equitable subordination defense, the movant would be deprived of secured status, thereby creating equity for the benefit of the estate.

10 *In re Poughkeepsie Hotel Assocs. Joint Venture*, 132 B.R. 287, 292-293 (Bankr. S.D.N.Y. 1991)
11 (internal citations omitted).

12 Similarly, in *In re Waste Alternatives, Inc.*, 171 B.R. 147, 148 (Bankr. M.D. Fla. 1994), a
13 secured creditor moved for relief from stay and the committee challenged the validity of the
14 creditor's lien. The court held that while it may not determine the invalidity of the lien in the
15 context of a relief from stay motion, it may consider evidence of the invalidity of the lien "in
16 determining the appropriateness of requiring the parties to litigate the lien's validity at all or the
17 need for adequate protection." *Id.* The court lifted the stay "only to the extent that an action filed
18 in a court of competent jurisdiction to determine the validity and extent of [the creditor's] lien."
19 The court concluded it would not lift the stay to allow foreclosure, nor grant adequate protection,
20 until after the determination of the validity of the creditor's lien. *Id.*

21 As succinctly summarized by a third court:

22 While the terms of 11 U.S.C. Section 362 suggest that the only issues to be litigated
23 are adequate protection, equity, and necessity to an effective reorganization, some
24 proof of the existence and amount of a debt must necessarily be an element of the
equity analysis. I seriously question whether this court can make a final
determination that the lien or the underlying debt is invalid outside the context of
an adversary proceeding (with the procedural due-process built into those
proceedings) or without benefit of a final judgment rendered in another forum.
Nevertheless, when presented with evidence in defense of a motion for relief that
strongly supports an inference that the lien might be held invalid in such a
proceeding, this court would be compelled to deny the motion and leave the stay in
effect for a sufficient time to allow the debtor to pursue other litigation.

28 *In re Rice*, 82 B.R. 623, 626 (Bankr. S.D. Ga. 1987) (emphasis added).

The priority of the Bank's liens and the estate's equity in the Real Property are subject to bona fide dispute. The Bank's own internal documents shows that it doubted the very validity of its own liens vis-a-vis the Purchasers. Indeed, the Bank's own reports show that it was concerned that its "[m]ain collateral is secured by a junior lien." At a minimum, the stay should be kept in place to allow the Debtor to investigate these issues and bring an action to determine the priority of the Bank's liens under Bankruptcy Rule 7001(2) so that the equity in the Real Property may be preserved for the benefit of unsecured creditors.

2. **California Law Grants the Purchasers Lien Rights Which May Be Preserved For the Estate.**

Under California law, the purchaser or vendee under an installment sales contract obtains an “equity ownership” in the real property though they do not hold legal title or have possession. *Tucker v. Lassen Sav. & Loan Ass’n*, 12 Cal.3d 629, 637-38 (Cal. Ct. App. 1974); *Marks v. Bunker*, 165 Cal.App.2d 695, 700 (1958). The purchaser’s equity interest functions like a security interest, guaranteeing the performance of the seller. *Taggart v. Cal-Linda Packaging Co.*, 146 Cal.App.2d 545, 548 (Cal. Ct. App. 1956); *Retsloff v. Smith*, 79 Cal.App.443, 448 (Cal. Ct. App. 1926); *Elliott v. McCombs*, 17 Cal.2d 23, 31 (Cal. 1941); *Los Angeles County v. Butcher*, 155 Cal.App.2d 744, 747 Cal. Ct. App. (1957).

18 Recording the installment sale contract imparts constructive notice of the purchaser's
19 equitable estate to subsequent purchasers or lienors. *Minaker v. Sunset Bldg & Real Estate Co.*, 25
20 Cal.App. 771, 774-75 (Cal. Ct. App. 1914); *Alhambra Redevelopment Agency v. Transamerica Fin.*
21 *Servs.*, 212 Cal.App.3d 1370, 1376 (Cal. Ct. App. 1989). A purchaser cannot enforce the equitable
22 estate against a subsequent purchaser or lienor without actual or inquiry notice of the installment
23 sale contract. *Beach v. Faust*, 2 Cal.2d 290, 293 (Cal. 1935); *Bernhard v. Wall*, 184 Cal. 612, 625,
24 630-31 (Cal. 1921).

The purchaser's equitable rights trump the lien of a subsequent lienor with notice or who is otherwise not a bona fide encumbrancer. A lienor has actual knowledge when that person "actually knows or could discover by making a reasonable investigation." *Perry v. O'Donnell*, 749 F.2d 1346, 1349-1351 (9th Cir. 1984). A person may have actual knowledge when someone tells

1 them of the prior interest (*Laughton v. McDonald*, 61 Cal.App. 678, 683 (Cal. Ct. App. 1923)
2 (vendee told a subsequent purchaser); *Lawton v. Gordon*, 37 Cal. 202, 205-06 (Cal. 1869) (recorder
3 told purchasers of prior deed)); the person overhears of the prior interest in a conversation (*Hart v.*
4 *Erickson*, 63 Cal.App.2d 719, 722 (Cal. Ct. App. 1944)); or where the person learns of the interest
5 from a document (*Beverly Hills Nat'l Bank & Trust Co. v. Seres*, 76 Cal.App.2d 255, 261-64 (Cal.
6 Ct. App. 1946)).

7 The purchaser's equitable rights manifest themselves in an equitable lien that has been
8 recognized by California's Legislature. See Civil Code §§ 3047-3050; *Montgomery v. Meyerstein*,
9 186 Cal. 459, 464-65 (Cal. 1921). In particular, section 3050 provides that "[o]ne who pays the
10 owner of any part of the price of real property, under an agreement for the sale thereof, has a special
11 lien upon the property, independent of possession, for such part of the amount paid as he may be
12 entitled to recover back, in case of a failure of consideration." A subsequent lienor who has
13 knowledge of the installment sale contract is subject to the vendee's lien though there is no
14 reference to the contract in the public records. *Lockie v. Co-operative Land Co.*, 207 Cal. 624, 628-
15 29 (Cal. 1929); *Kees v. Beardsley*, 190 Cal. 465, 470-71 (Cal. 1923) (vendee lien senior to optional
16 advance under deed of trust); *Garcia v. Atmajian*, 113 Cal.App.3d 516, 520-21 (Cal. Ct. App.
17 1980); *Bartley v. Karas*, 150 Cal.App.3d 336, 340-41 (Cal. Ct. App. 1983), *disapproved on other*
18 *grounds by Petersen v. Hartell*, 40 Cal.3d 102 (Cal. 1985). For example, in *Bartley v. Karas*, the
19 court determined that the purchaser's lien was senior to the recorded deed of trust because the
20 beneficiary of the deed of trust was the broker that facilitated the sale to the purchaser.

21 In this instance, there is no evidence that the Purchasers recorded their purchase agreements
22 with the County Recorder. That does not end the Court's inquiry. The evidence is the Bank was
23 aware of the purchase agreements before providing its financing. The Bank not only knew of the
24 equitable lien claim but recognized its significance in internal memoranda. While unperfected
25 against third parties, any equitable lien rights of the Purchasers under section 3050 of the California
26 Civil Code would therefore be valid, enforceable, and senior to any interests of the Debtor and the
27 Bank. These senior, unperfected liens may be avoided and preserved for the benefit of all creditors.
28 See 11 U.S.C. §§ 544(a)(3), 551; see, e.g., *In re Kaltenheuser*, 474 B.R. 305 (Bankr. D.D.C. 2012)

1 (stay relief denied because debtor held colorable claim under section 544(a)(3)). If the Bank is
2 granted relief from the automatic stay, the estate will be deprived of a significant right to preserve
3 equity in the Real Property for unsecured creditors.

4 **B. THE REAL PROPERTY IS NECESSARY FOR AN EFFECTIVE
5 REORGANIZATION**

6 The Real Property is unquestionably necessary for an effective reorganization. According
7 to the Debtor's Schedules, the Real Property is the estate's only asset. Should the Debtor succeed
8 in contesting the priority of the Bank's liens, the Debtor will be able to sell the Real Property to
9 provide a significant distribution to unsecured creditors.

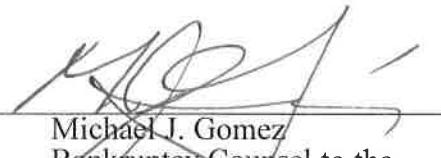
10 **III. CONCLUSION**

11 Based on the arguments and authorities set forth above, the Committee respectfully requests
12 that this Court enter an Order:

- 13 1. Denying relief from the automatic stay; or, alternatively,
14 2. Conditioning the automatic stay subject to the Debtor prosecuting an action against
15 the Bank pursuant to 11 U.S.C. §§ 544(a)(3), 551, and Bankruptcy Rule 7001(2) to
16 determine the priority of any equitable liens held by the Purchasers, avoid those
17 liens, and preserve them for the benefit of the estate; and
18 3. For such other and further relief as the Court deems just and proper.

19
20 Dated: October 1, 2013

21 LANG, RICHERT & PATCH, P.C.

22 By 

23
24 Michael J. Gomez
25 Bankruptcy Counsel to the
Official Unsecured Creditors
Committee of TWN Investment
Group, LLC
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